563

FILE COPY

SUPREME COURT, U. S.
FILED
OCT 7 1972
MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1972.

No. ~~72-~~ 563

KEITH B. McKY,

Petitioner,

vs.

UNION BANK AND TRUST COMPANY OF HELENA, MONTANA, AS EXECUTOR OF THE ESTATE OF ARNOLD C. SCHUEREN, DECEASED,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

CHARLES AARON,
MICHAEL L. WEISSMAN,
33rd Floor-East,
One First National Plaza,
Chicago, Illinois 60670,
Attorneys for Petitioner.

THE GUNTHORP-WARREN PRINTING COMPANY, CHICAGO

INDEX.

PAGE

Opinions Below 1

Jurisdiction 2

Question Presented 2

Should a United States Court of Appeals adjudicate an issue of common law agency by prescribing its own rule of substantive law rather than by following the controlling state decisions?

Statement of the Case 2

Reason for Granting the Writ 6

A United States Court of Appeals should not be permitted to adjudicate an issue of substantive law by disregarding all applicable state decisions and by prescribing its own rule of substantive law since this violates the mandate of *Erie R. Co.* v. *Tompkins* and constitutes the substitution of federal common law for the governing state law.

Conclusion 12

Appendix:

Report of the Special Master A1

Opinion and Judgment of the United States District Court for the Northern District of Illinois. A11

Opinion and judgment of the United States Court of Appeals for the Seventh Circuit A17

CITATIONS.

Cases.

Blackburn v. Witter, 201 Cal. App. 2d 518, 19 Cal. Rptr. 842 (1962) 8, 9, 10

Bosak v. Parrish, 252 N. Y. 212, 169 N. E. 280 (1929) . 10, 11

Clements v. Macheboeuf, 92 U. S. 418 (1876) 9, 10

Columbia v. Lee, 243 App. Div. 361, 277 N. Y. Supp. 161 (1935) 10

Erie R. Co. v. Tompkins, 304 U. S. 64 (1938) 7, 11

Fay v. Slaughter, 194 Ill. 157, 62 N. E. 592 (1901) . . 9, 10, 11

Fidelity Co. v. Continental Bank, 303 Ill. App. 595, 25 N. E. 2d 550 (1940) 9, 10, 11

Gratz v. Land & River Imp. Co., 82 Fed. 381 (7th Cir. 1897), *cert. den.*, 173 U. S. 705 (1898) 9

Hartzler v. Chesapeake and Ohio Railway Company, 433 F. 2d 104 (7th Cir. 1970) 8

Holladay v. Daily, 86 U. S. (19 Wall.) 606 (1873) 9

Klaxon Company v. Stentor Electric Manufacturing Company, Inc., 313 U. S. 487 (1941) 8, 11

LeRoy v. Beard, 49 U. S. (8 How.) 451 (1850) 9

Rosen v. Harde, 238 App. Div. 622, 265 N. Y. Supp. 154 (1933) 10, 11

Runkle v. Burnham, 153 U. S. 216 (1894) 10

Very v. Levy, 54 U. S. (13 How.) 345 (1851) 9

West v. American Telephone and Telegraph Co., 311 U. S. 223 (1940) 7, 11

William v. Conger, 125 U. S. 397 (1888) 10

IN THE

Supreme Court of the United States

OCTOBER TERM, 1972.

No. .....

KEITH B. McKY,

Petitioner,

vs.

UNION BANK AND TRUST COMPANY OF HELENA, MONTANA, AS EXECUTOR OF THE ESTATE OF ARNOLD C. SCHUEREN, DECEASED,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

The petitioner, Keith B. McKy, respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit entered on August 1, 1972.

OPINIONS BELOW.

The opinion of the United States Court of Appeals for the Seventh Circuit, which has not yet been reported, is reproduced in full text in the Appendix hereto (pp. A17 to A26). The opinion of the United States District Court

for the Northern District of Illinois, which was not reported, is reproduced in full text in the Appendix hereto (pp. A11 to A16) as is the Report of the court-appointed Special Master (pp. A1 to A10) which was confirmed in the opinion of the District Court.

JURISDICTION.

The judgment of the United States Court of Appeals for the Seventh Circuit was entered on August 1, 1972. This petition for a writ of certiorari was filed within ninety (90) days of that date. This Court's jurisdiction is invoked under 28 U. S. C. § 1254(1).

QUESTION PRESENTED.

Should a United States Court of Appeals adjudicate an issue of common law agency by prescribing its own rule of substantive law rather than by following the controlling state decisions?

STATEMENT OF THE CASE.

The petitioner herein is the court-appointed Receiver of the property and assets of First Securities Company of Chicago ("First Securities"). The respondent, Union Bank and Trust Company of Helena, Montana (the "Bank"), is the Executor of the Estate of Arnold C. Schueren, deceased. The Bank has asserted a claim against the property and assets of First Securities. The Securities Exchange Commission (the "Commission") and the Customer Creditors Committee of First Securities are parties to the proceedings below but are not seeking review of the judgment and opinion below.

The petitioner directs attention to the fact that this petition for a writ of certiorari arises out of the same

receivership proceeding described in the petition for a writ of certiorari docketed in this Court on August 10, 1972 as No. 72-235.

NATURE OF THE CASE.

On June 4, 1968, Leston B. Nay ("Nay"), President of First Securities, was found dead under circumstances indicating suicide; a suicide note was found admitting that there were improprieties in the handling of the accounts of certain of Nay's customers.

At the time of Nay's death, First Securities was engaged in a stock brokerage business; it was registered with the Commission as a broker-dealer in securities and was a member of the Midwest Stock Exchange and the National Association of Securities Dealers, Inc.

Nay's suicide note indicated that he had been misappropriating funds and securities for many years. An investigation was immediately commenced by the Commission. Based upon the findings of its investigatory staff, the Commission began this proceeding on June 10, 1968. In its complaint the Commission sought injunctive relief against First Securities and the appointment of a Receiver. The action was brought under Section 27 of the Securities Exchange Act of 1934, as amended, 15 U. S. C. § 77v(a). In its complaint, the Commission alleged that there had been violations of both Section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b), as amended, and Section 17(a) of the Securities Act of 1933, 15 U. S. C. § 77a(a), as amended. A preliminary injunction was entered enjoining First Securities from the transaction of any further business; at a later date, the injunction was made permanent. On June 17, 1968, on the motion of the Commission, the petitioner was appointed Receiver of First Securities.

On July 26, 1968, an order was entered fixing the time and prescribing the form and manner of filing proofs of

claim. The Bank, which had been designated to administer the estate of the late Arnold C. Schueren, filed a proof of claim with the Receiver and a petition for reclamation of securities which the Bank contended were in the hands of the Receiver.

Some of the securities claimed by the Bank were found and, in accordance with the recommendations of Charles A. Bane, Esq., the Special Master appointed by District Judge Julius J. Hoffman, an order was entered on August 19, 1969 directing that these securities be returned to counsel for the Bank.

However, inasmuch as certain of the securities claimed by the Bank could not be found, hearings were held before the Special Master on the question of whether the Bank had any claim against First Securities for the value of the missing securities. Mrs. Eleanore A. Schueren, the widow of the late Arnold C. Schueren, had also presented a proof of claim and a petition for reclamation and her claim was heard by the Special Master concurrently with the claim of the Bank.

In his Report dated June 30, 1970 (pp. A1 to A10), Special Master Bane concluded that the Bank's claim for the value of the missing securities should not be allowed because the late Arnold C. Schueren had given Nay a broad power of attorney. The Master further found that the power of attorney made Nay the agent of Schueren rather than the agent of First Securities as to all securities transactions and that there was no evidence the power of attorney had ever been revoked. On the other hand, the Special Master concluded that the claim of Mrs. Eleanore A. Schueren for those of her securities which were missing should be allowed since Mrs. Schueren had never given a power of attorney to Leston B. Nay.

On March 22, 1971, the Special Master's Report was filed with Judge Hoffman and the petitioner thereupon moved

to confirm said Report insofar as it related to the claim of the Bank. On March 22, 1971, Judge Hoffman delivered an opinion from the bench approving the Special Master's Report (pp. A11 to A16), and entered an order disallowing the claim of the Bank.

The Bank appealed to the United States Court of Appeals for the Seventh Circuit which reversed the judgment of the District Court (pp. A17 to A26).

THE FACTS

The late Arnold C. Schueren ("Schueren") and his wife, Eleanore A. Schueren, were close personal friends of the late Leston B. Nay for many years. They were also customers of the various securities firms by which Nay was employed prior to his association with First Securities.

Approximately three years preceding the date on which First Securities came into existence, Schueren gave Nay a power of attorney (I App. 101-102) which granted to Nay authority "to act for me in connection with all matters arising out of or in any way connected with my securities to the same extent and with the same full power and authority as I might personally do if present." This power of attorney was amended the following year (I App. 100), which amendment confirmed the prior power of attorney, granted even greater discretionary authority to Nay and provided that the authority granted thereunder would continue in effect until revoked in writing. There is no evidence whatever in the record that the power of attorney was revoked prior to the death of Schueren.

Schueren died in 1967 and the Bank was designated as executor of his estate. After Schueren's death the Bank corresponded with Nay about Schueren's securities as part of its administration of Schueren's estate. However, at the time of Nay's death the Bank had received none of the

securities which were allegedly included in Schueren's estate.

First Securities was organized as an Illinois corporation and had its only offices in Chicago and Champaign, Illinois. Virtually all the banking and accounting and correspondence pertaining to Schueren's account was handled by Nay in Chicago. Although the Schuerens lived in Montana at the time of Arnold C. Schueren's death, they had become acquainted with Nay and had become his customers while residing in the Chicago area.

REASON FOR GRANTING THE WRIT.

A United States Court of Appeals Should Not Be Permitted to Adjudicate an Issue of Substantive Law by Disregarding All Applicable State Decisions and by Prescribing Its Own Rule of Substantive Law Since this Violates the Mandate of Erie R. Co. v. Tompkins and Constitutes the Substitution of Federal Common Law for the Governing State Law.

Although the proceeding in the District Court was commenced by the Commission in reliance upon federal securities legislation, the question of whether or not the claim of the Bank should be allowed was adjudicated primarily by reference to the common law of agency rather than any federal statute.

In the instant proceeding, the Court of Appeals reversed the District Court and held that Nay had acted as the common law agent of First Securities in converting Schueren's property. The Court of Appeals summarily rejected the conclusion of the Special Master and the District Court that Schueren had designated Nay as his agent because Schueren had executed and delivered to Nay a broad and comprehensive power of attorney *long before First Securities had even been organized.*

The issue of substantive agency law presented to the Court of Appeals, i.e., whether the power of attorney made Nay the agent of Schueren, had to be determined by reference to Illinois law. Schueren gave Nay the power of attorney in Illinois and delivered his securities to Nay in Illinois and Nay converted Schueren's securities in Illinois. The Bank never contended that any law other than Illinois law was controlling on this common law agency issue. Similarly, neither the Special Master nor the District Court ever considered that Illinois law would not be applied. But the Court of Appeals utterly disregarded the decisional law of Illinois and relied exclusively upon an opinion it had delivered on April 12, 1972 in a related appeal.[1] This prior opinion cannot be deemed determinative of the issue herein since it decided an issue of Illinois agency law by reference to an isolated California decision which was clearly inconsistent with all of the controlling Illinois cases. And by insisting upon the application of California law rather than Illinois law to a matter governed by Illinois law, the Seventh Circuit, in its prior opinion, in substance, substituted a federal common law of agency for the applicable state law. This violated the fundamental precepts of *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938) and the numerous decisions of this Court which unequivocally hold that a federal court, when faced with a question of purely local law, must ascertain and apply the governing local law rather than prescribe its own rule of substantive law.

In both its prior opinion and its opinion herein, the Seventh Circuit should not have fashioned its own rule of substantive agency law since it was under a mandate to apply Illinois law.

In *West* v. *American Telephone and Telegraph Co.*, 311 U. S. 223, 237 (1940), this Court referred to the *Erie* doc-

1. Petitioner is seeking review of this opinion of the Seventh Circuit in a separate petition for a writ of certiorari filed in this Court on August 10, 1972 which has been docketed as No. 72-235.

trine and admonished a lower federal court for failure to ascertain and apply local rules of decision to a matter of local substantive law saying:

> "State law is to be applied in the federal as well as the state courts and it is the duty of the former in every case to ascertain from all the available data what the state law is and apply it rather than to prescribe a different rule, however superior it may appear from the viewpoint of 'general law' and however much the state rule may have departed from prior decisions of the federal court."

The foregoing was reiterated by this Court in *Klaxon Company* v. *Stentor Electric Manufacturing Company, Inc.*, 313 U. S. 487 (1941), a diversity of citizenship case in which this Court held that the *Erie* doctrine required a Delaware federal court to apply state law, it being said at 313 U. S. 497:

> "... the proper function of the Delaware federal court is to ascertain what the state law is, not what it ought to be."

In its opinions in both the instant appeal and the prior appeal, the Seventh Circuit not only failed to adhere to the foregoing decisions of this Court, it also totally overlooked its own opinion in *Hartzler* v. *Chesapeake and Ohio Railway Company*, 433 F. 2d 104 (7th Cir. 1970). In the *Hartzler* case the Seventh Circuit discussed its obligation under the *Erie* doctrine observing at 433 F. 2d 107:

> "The responsibility of the federal courts, in matters of local law, is not to formulate the legal mind of the state but merely to ascertain and apply it."

The opinion of the Seventh Circuit in the prior appeal did not deal with Illinois law but was based exclusively upon *Blackburn* v. *Witter*, 201 Cal. App. 2d 418, 19 Cal. Rptr. 842 (1962). Since the instant opinion of the Court of Appeals relies entirely upon its prior opinion, the Court of Appeals

has therefore concluded that *Blackburn* v. *Witter* also provides the law applicable to this proceeding. However, *Blackburn* v. *Witter*, a decision of the intermediate appellate court in California, cannot provide the controlling law in this case. *Blackburn* v. *Witter* is of no assistance whatsoever in ascertaining and applying the law of Illinois; it was decided solely by reference to a provision of the California Civil Code (Calif. Civil Code § 2317) rather than as a matter of general agency law.

Moreover, even assuming that its opinion in the prior appeal provided some limited point of reference, the Seventh Circuit erred in relying upon *Blackburn* v. *Witter* herein because *Blackburn* v. *Witter* in no way involved a written power of attorney.

By reversing the District Court in this proceeding, the Seventh Circuit has failed to recognize that Illinois law controls and that Illinois law plainly calls for the conclusion that the power of attorney made Nay the agent of Schueren rather than First Securities when he dealt with Schueren's property. The opinion of the Seventh Circuit is contrary to this well-settled rule of Illinois law and contrary to one of the most fundamental rules of common law agency jurisprudence.

In Illinois the execution and delivery of a written power of attorney makes the recipient of the power the agent of the grantor for the performance of all of the acts contemplated by the power. *Fay* v. *Slaughter*, 194 Ill. 157, 166, 62 N. E. 592 (1901); *Fidelity Co.* v. *Continental Bank*, 303 Ill. App. 595, 25 N. E. 2d 550 (1940). This same rule was recognized by the Seventh Circuit many years ago. See, *Gratz* v. *Land & River Imp. Co.*, 82 Fed. 381 (7th Cir. 1897), *cert den.*, 173 U. S. 705 (1898). Moreover, there are numerous decisions of this Court which plainly recognize this doctrine. *LeRoy* v. *Beard*, 49 U. S. (8 How.) 451 (1850); *Very* v. *Levy*, 54 U. S. (13 How.) 345 (1851); *Holladay* v. *Daily*, 86 U. S. (19 Wall.) 606 (1873); *Clements*

v. *Macheboeuf*, 92 U. S. 418 (1876); *Williams* v. *Conger*, 125 U. S. 397 (1888); *Runkle* v. *Burnham*, 153 U. S. 216 (1894).

Because there was no Illinois decision squarely on point with the facts presented herein, the Special Master and the District Court relied upon *Rosen* v. *Harde*, 238 App. Div. 622, 265 N. Y. Supp. 154 (1933) in holding that the power of attorney made Nay the agent of Schueren. *Rosen* v. *Harde* is so closely analogous to the instant case as to be virtually indistinguishable. And *Rosen* v. *Harde* is much more consistent with Illinois cases such as *Fay* v. *Slaughter*, *supra*, and *Fidelity Co.* v. *Continental Bank*, *supra*, than is *Blackburn* v. *Witter*. The Court of Appeals chose to disregard *Rosen* v. *Harde* on the grounds that it was an isolated case which had not been widely followed. But *Rosen* v. *Harde* is far less "isolated" than *Blackburn* v. *Witter* upon which the Court of Appeals placed its sole reliance. *Columbia* v. *Lee*, 243 App. Div. 361, 277 N. Y. Supp. 161 (1935), which also involved a power of attorney executed and delivered by a customer of a stock brokerage firm, follows the rationale of *Rosen* v. *Harde*. Furthermore, both *Rosen* v. *Harde* and *Columbia* v. *Lee* draw upon an opinion written by Justice Cardozo when sitting as Chief Judge of the Court of Appeals of New York. In *Bosak* v. *Parrish*, 252 N. Y. 212, 169 N. E. 280 (1929), the plaintiff, a customer of a stock brokerage firm, had opened an account with the defendant stock brokers and had executed and delivered a general power of attorney in favor of one Medinger, an employee of the defendants. Discussing the effect of the written power of attorney executed and delivered by the plaintiff, Justice Cardozo said at 252 N. Y. 215:

> "There can be no question under the findings that as long as this power of attorney stood unchanged and unrevoked, the defendants were protected in acting

> upon orders transmitted to them by Medinger in behalf of his principal, the plaintiff, as upon orders from the plaintiff personally."

In reversing the judgment entered by the lower court in favor of the plaintiff, Justice Cardozo said at 252 N. Y. 216:

> "We think the judgment is at variance with basic principles of agency. The power of attorney was lodged by the plaintiff with his brokers for the very purpose of accrediting the agent thereby appointed as his plenary representative. The brokers could safely act upon the authority thereby conferred until notified by the customer, the signer of the power, that it had been altered or withdrawn [citations omitted]."

On the basis of Illinois decisions such as *Fay* v. *Slaughter, supra*, and *Fidelity Co.* v. *Continental Bank, supra*, it is beyond contest that an Illinois court, when faced with the question which was presented to the Seventh Circuit herein, would follow *Rosen* v. *Harde* as did the Special Master and the District Court. However, the Seventh Circuit has refused to do so. The Seventh Circuit has elected instead to adjudicate this matter by reference to its prior opinion in the related appeal wherein it relied exclusively upon a California case to determine a question of Illinois agency law and wherein no written power of attorney was involved.

Because the Seventh Circuit has chosen to disregard the decisions which an Illinois court would apply and to fashion its own rule of substantive law which cannot be reconciled with Illinois law, it has totally disregarded the *Erie* doctrine. If *Erie* v. *Tompkins, supra*, *West* v. *American Telephone and Telegraph Co., supra*, and *Klaxon* v. *Stentor, supra*, are to retain their vitality and the federal judiciary is to be reminded of its obligation to ascertain and apply governing state law on issues of state law, this Court should grant certiorari to review the judgment of the Seventh Circuit.

CONCLUSION.

For the above and foregoing reasons a Writ of Certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Seventh Circuit.

Respectfully submitted,

CHARLES AARON,
MICHAEL L. WEISSMAN,
33rd Floor-East,
One First National Plaza,
Chicago, Illinois 60670,
Attorneys for Petitioner.

October, 1972.

APPENDIX.

REPORT OF SPECIAL MASTER CHARLES A. BANE

IN RESPECT OF THE CLAIM OF

UNION BANK AND TRUST COMPANY OF HELENA, MONTANA AS EXECUTOR OF THE ESTATE OF ARNOLD C. SCHUEREN, DECEASED

FILED AUGUST 28, 1970.

IN THE DISTRICT COURT OF THE UNITED STATES

For the Northern District of Illinois

Eastern Division

SECURITIES AND EXCHANGE COMMISSION, *Plaintiff,* *vs.* FIRST SECURITIES COMPANY OF CHICAGO, a corporation, *Defendant.*	Civil Action No. 68 C 1053

REPORT OF THE COURT'S SPECIAL MASTER IN RESPECT OF CLAIMS OF ELEANORE A. SCHUEREN AND UNION BANK AND TRUST COMPANY, AS EXECUTOR OF THE ESTATE OF ARNOLD C. SCHUEREN

On August 2, 1968, Eleanore A. Schueren and Union Bank and Trust Company, as Executor of the Estate of Arnold C. Schueren, filed Reclamation Petitions alleging that each of the Schuerens, who were husband and wife, had accounts with the defendant, First Securities Company of Chicago; that substantial amounts of securities belonging to them had been entrusted to First Securities and its agents for safekeeping. The Reclamation Petitions accordingly prayed for the return of the securities or the proceeds from their disposition. Thereafter, following a hearing, the Court's Special Master recommended that there be turned over to the respective Petitioners such securities as had been found and were acknowledged to be in the possession of the receiver; this report was adopted by the Court as its Order dated August 19, 1969.

However, there remain substantial securities which have never been found and which formed the basis of the remaining claims now to be considered for disposition in this Memorandum. Hearings on these remaining claims were held on September 16, November 5 and 6, 1969.

The Petitioners have presented expert testimony to the effect that the total value of the securities, exclusive of those which have previously been turned over, is $394,195.39 in the case of Petitioner Union Bank and Trust Company for Arnold C. Schueren, and $17,030.97 for securities claimed by Eleanore Schueren.

The evidence shows that Arnold Schueren's relationships with Leston B. Nay began at least as early as the year 1936. On April 16, 1936, Arnold Schueren granted to Nay a Power of Attorney (in evidence as RX 2) which was amended July 7, 1937 (in evidence as RX 1). The Power of Attorney authorized and empowered Nay to sell Arnold Schueren's securities, to reinvest the proceeds and to make any changes by exchange, sale or purchase as Nay might deem advisable in his sole discretion in the following language (1936 Power of Attorney, RX 2):

> "KNOW ALL MEN BY THESE PRESENTS, that I, the undersigned, A. C. Schueren, make, constitute and appoint Leston B. Nay, of the City of Chicago, Illinois, my attorney in fact, to act for me in connection with all matters arising out of or in any way connected with my securities to the same extent and with the same full power and authority as I might personally do if present:
>
> > "Without detracting from the generality of the foregoing powers and authorities, I specifically authorize and empower the said Leston B. Nay to continue to retain securities now held by me, to direct the sale of said securities or any part or portion thereof and determine upon the character of reinvestment of the monies arising from any disposition of same. It is my intention that said Les-

ton B. Nay shall have full power and authority to make any changes desired by exchange sale or purchase in connection with the securities herein above mentioned which in his sole discretion he may deem advisable; and I do further ratify any and all acts which may be taken by the said Leston B. Nay as my attorney-in-fact under and by virtue thereof.

"This Power of Attorney shall continue in force until revoked by me.

"IN WITNESS THEREOF, I have hereonto set my hand and seal this 16 day of April, 1936.

/s/ A. C. SCHUEREN (Seal)"

At that time, Nay was associated with Webber, Darch & Co. Thereafter in 1942, Nay left Webber, Darch to begin an association with Ryan Nichols & Co., and Arnold Schueren's account was transferred from Webber, Darch to Ryan Nichols. First Securities Co. of Chicago, of which Nay became President, Chief Executive Officer and 90 per cent shareholder, is a successor to Ryan Nichols.

At the time of the transfer of the Arnold Schueren account from Webber, Darch to Ryan Nichols, Leston Nay, signing as Vice President of Ryan Nichols, transmitted to Arnold Schueren, on Ryan Nichols' letterhead, a list of securities which "we have received from Webber, Darch & Co. [and] placed in safekeeping for your account" (Petitioner's Exhibit 1-209-210, in evidence). Thereafter, the Arnold Schueren account was handled exclusively by Leston Nay who, over the years, delivered various safekeeping receipts and income statements on First Securities' forms to Arnold Schueren. Dividends and interest were remitted to Arnold Schueren by cashier's checks, accompanied by income statements on First Securities letterhead.

Testimony of Roy Campbell, long time bookkeeper for First Securities, was to the effect that First Securities itself never used cashier's checks to make income remittances

to customers, that the income remittances to Arnold Schueren did not come out of the bank account of First Securities and that the books and records of First Securities showed no securities or money balances owing to Arnold Schueren (Transcript 308-9, 367-8, 325-6).

Several inventories of securities purportedly held for Arnold Schueren were furnished. On March 17, 1959, Arnold Schueren was furnished on First Securities letterhead an unsigned statement of "account of Mr. Arnold C. Schueren, Pray, Montana" (Petitioner's Exhibit No. 1-199 to 202). Mr. Schueren thereafter wrote to Nay advising him of certain discrepancies in this inventory; Nay replied on First Securities letterhead acknowledging the errors and advising of their correction (Petitioner's Exhibit No. 1-203 and 1-204).

Upon Arnold Schueren's death in 1967, Union Bank and Trust Company as Executor of his Estate, requested from Nay that First Securities forward to the bank "all of the bonds, securities and assets you hold for Arnold C. Schueren." The Bank received what purported to be an inventory of securities held in safekeeping, the inventory bearing the stamp of "First Securities Co. of Chicago" on each page. It was accompanied by a letter from Nay on First Securities letterhead which referred to the inventory as the "statement of the entire account" (Petitioner's Exhibit 1-84). This inventory has been stated by Petitioner Union Bank to be "the primary basis" for its claim (Petitioner's Brief to the Special Master, Page 6).

None of the securities listed on the inventory delivered to Union Bank and Trust Company were ever delivered to the Bank, Nay explaining in response to numerous requests that a number of the securities were out for transfer. Nay continued to send monthly income statements to the Union Bank as Executor, accompanied by cashier's checks for the amount of the total income purportedly derived from the securities as shown on the monthly income statements.

On June 4, 1968, Nay was found shot to death under circumstances indicating suicide and leaving a note, in Nay's handwriting, which stated as follows with reference to the Schueren claims:

"Roy:

"Do not open the office for business Monday, June 3 —due to my thefts, the Company is bankrupt—

"The thefts affecting the Company are

"(1) The Schueren account (Union Bank of Helena —Loomis—Continental Bank

[Recitation of the Location of Various Items]

"6. Schueren—and Estate file (Union Bank and Trust Co., Helena, Montana)

"(1) In my brief case on desk of my bedroom in apartment and bottom drawer of office safe. *Defalcation of Schueren's securities starting in 1939 I think (whenever his first power of attorney to me is dated)* see one of the files in bottom drawer of office safe—also see receipt issued for his securities in Safe-Keeping received by Ryan Nichols & Co. from Webber Darch Co. in June of 1942 interest and dividends on 'Safe Keeping' items paid by cashier's check I bought at Continental Bank.—Some stocks he sent in for safe-keeping (still in his name) are in my safety box at Continental Bank, together with his wife's securities, bought through us, such as: Swift, General Public Service, etc.—other items on monthly income statements are of course spurious—

"Real securities belonging to both accounts were sold through City National and Continental, having been used as collateral.

• • • • •

"Re: Schueren Estate:

"I stalled Union Bank in Helena (Herbert Mayer) see correspondence, till now. I phoned him today say-

ing that most securities are back from transfer Monday—

• • • • •

"June 1, 1968—I had no accomplices and no help in these thefts."

(Underscoring supplied.)

The securities, the value of which is sought in these proceedings on behalf of Arnold Schueren, were listed or referred to on one or more of the inventories, monthly income statements or safekeeping receipts introduced in evidence. These circumstances closely resemble those of Nora A. Moyer where the Court approved the recommendation of the Special Master that the transactions should be regarded as those of First Securities and that First Securities should, therefore, be liable for Nay's activities. In *Moyer*, as here, fraudulent conversions of securities were effected by Nay at the same time that he was furnishing receipts and statements concerning securities held and the income therefrom on letterhead of First Securities. The Court approved the Special Master's definition in *Moyer* of the root question as being whether the transactions purported to have been carried out on the broker's side by Nay as an individual or by him as an agent or representative of First Securities; and the Court agreed with the Special Master's recommendation that the transactions be found to have been carried out by Nay as an agent or representative of First Securities.

The Court added in *Moyer* that a second question had to be faced, related to the intentions of Mrs. Moyer: viz., whether she intended to rely on Nay as an individual or as an agent of First Securities in her dealings with him. (Transcript of Proceedings, April 30, 1969, Pages 7-8). Facing up to this second question with reference to the Arnold Schueren claim, the Special Master is unable to

reach any conclusion other than that Arnold Schueren intended to deal with Nay individually rather than as an agent of First Securities. The Power of Attorney granted by Schueren to Nay named Leston B. Nay individually without any designation of a representative capacity. It gave Nay full power and authority regarding Schueren's securities. That the Power of Attorney was not intended to run to Nay as a representative of First Securities is conclusively shown by the circumstance that the power was executed at least three years prior to the incorporation of First Securities and approximately six years prior to the time that Nay had any connection with First Securities or its predecessor company.

That the Power of Attorney was the instrument by which Nay was able to effect the fraudulent conversion of Arnold Schueren's securities is indicated, although not necessarily proved, by the circumstance that the Nay suicide note dates the beginning of such conversions (called "defalcation of Schueren's securities" in the note) by stating that it started "in 1939, I think (whenever his first power of attorney to me is dated)."

Under all the circumstances, it is clear that Nay in his transactions in securities of Arnold Schueren was acting as Schueren's agent and not as the agent or representative of First Securities. A decision of the Appellate Division of the Supreme Court of New York is directly in point: *Rosen v. Harde, et al.*, 238 App. Div. 622, 265 N. Y. Supp. 154 (1933). In that case a plaintiff, seeking to recover from a brokerage house for its alleged failure to execute two orders, had opened his account with the broker through a customer's man, Weinstock, and had given to him what the Court refers to as "the usual customer's agreement" by which Weinstock had a Power of Attorney over the account. The Court found that it should have been ruled as a matter of law that the orders given to Weinstock were given to him

as the customer's agent and not as agent of the brokerage house and that the brokerage house was not liable for the manner in which Weinstock acted under the Power of Attorney.

Accordingly, the Special Master concludes that in his defalcations from the Arnold Schueren accounts, Nay was acting under the Power of Attorney given to him by Arnold Schueren, that accordingly, he was the agent of Arnold Schueren and not of First Securities and that First Securities should not be held responsible for the losses sustained by Arnold Schueren. It is, therefore, recommended that the Petition of Union Bank & Trust Company, acting as Executor for the Estate of Arnold Schueren, for the recognition of claims (other than claims to securities which have been heretofore found and turned over) should be denied.

The claim of Eleanore Schueren differs from that of the Union Bank on behalf of her husband in two respects: first, Mrs. Schueren had never executed a power of attorney of any kind to Leston B. Nay, and second, her claims are predicated not on any inventory but primarily on documents purporting to be safekeeping receipts and monthly statements of her account, all on First Securities forms or letterhead. Amounts shown on the monthly statements to be owing for dividends and interest were transmitted to Mrs. Schueren by cashier's check.

The Receiver argues (Receiver's Brief, Page 23) that the circumstance that payments were made by cashier's check should have alerted Mrs. Schueren to the irregularities in the handling of her account and that accordingly, she did not exercise reasonable care with respect to her account. But the Special Master is unable to conclude that this circumstance, taken with the fact that statements and receipts being furnished to Mrs. Schueren purported to be those of First Securities, would be sufficient, standing alone, to lead

to a finding that Mrs. Schueren should have realized that First Securities was not in charge of her account. Under all the circumstances, Mrs. Schueren's situation and relationships with Nay closely resemble those of Mrs. Moyer, and accordingly, the Special Master recommends that the claims of Mrs. Schueren be recognized.

As to the valuation, expert testimony was presented on behalf of Eleanore Schueren that the total value of securities claimed by her in these proceedings is $17,030.97 based upon a valuation as of June 10, 1968 (Petitioner's Exhibit 10-2).

In the *Moyer* matter, the Court laid down the basic rules as to the date of valuation in the case of conversions carried out in Illinois. The Court stated that it is well established in Illinois that the proper measure of damages is the current market value of the property at time of conversion. Where the date of conversion is beyond ascertainment, the Court in *Moyer* pointed out that it would not be unreasonable to believe that the Illinois courts in such a situation "would deviate from the rule in *Sturgis* v. *Keith*, at least to the extent of allowing values as of the date of notice to the owner of the conversion, if not as of a date a reasonable time thereafter in which replacement stock might have been purchased." (Transcript of Proceedings, April 30, 1969, pages 10-13)

Accordingly the Court expressly approved in *Moyer* valuation as of the date of first notice of the conversion, which was for Mrs. Moyer, June 10, 1968, the date of filing of the complaint by the Securities and Exchange Commission in this proceeding. In the light of this precedent, the Special Master recommends, since there is little difference, if any, between the situations of Mrs. Moyer and Mrs. Schueren, that the converted securities of Mrs. Schueren should likewise be valued as of June 10, 1968. Since that is the date as of which the valuation was made by Petitioners' expert wit-

ness, the Special Master recommends the recognition of the claim of Mrs. Eleanore A. Schueren in the amount of $17,030.97 testified to by the expert witness.

The Receiver has raised a question (See Receiver's Brief, Pages 21-22) concerning the recognition as a part of Mrs. Schueren's claim of $6,000.00 Boston and Maine and $1,000.00 New York, New Haven and Hartford Bonds. The course of the actual transactions is muddied, involving the issuance of safekeeping receipts in 1956 and 1957, and a later purchase and sale of like amounts of bonds in 1962, but the Special Master does not regard the evidence as sufficiently convincing to require elimination of these Bonds from Mrs. Schueren's claim.

During the course of the hearing and argument there was raised the question with respect to whether testimony concerning conversations with Leston B. Nay is admissible in view of the Illinois Dead Man's Statute (Chapter 51, Section 4, Illinois Revised Statutes). In these proceedings, such testimony was admitted in the record subject to later ruling. The Special Master hereby avers, however, that none of his recommendations herein is based upon such testimony and accordingly, the Special Master does not recommend to the Court a ruling one way or the other on this evidentiary point.

In summation, the Special Master recommends to the Court (i) the denial of the claim of Union Bank and Trust Company, as Executor of the Estate of Arnold C. Schueren, in the claimed amount of $394,195.39, and (ii) the recognition and approval of the claim of Mrs. Eleanore A. Schueren, in the claimed amount of $17,030.97.

CHARLES A. BANE
Special Master

June 30, 1970.

COPY BOUND

OPINION OF UNITED STATES DISTRICT JUDGE

JULIUS J. HOFFMAN

DELIVERED MARCH 22, 1971.

ND CLOSE IN CENTER

COPY B

IN THE DISTRICT COURT OF THE UNITED STATES
* * (Caption—68 C 1053) * *

OPINION.

JUDGE HOFFMAN: This matter involves claims asserted against the First Securities Company of Chicago by Eleanore A. Schueren and the Union Bank and Trust Company, as Executor of the Estate of Arnold C. Schueren. The reclamation petitions filed by Mrs. Schueren and the Executor of her late husband's estate alleged that both of the Schuerens had accounts with First Securities, and that substantial amounts of securities belonging to them had been entrusted to First Securities for safekeeping. Following a hearing on the prayer for the return of the securities or the proceeds from their disposition, the Court's Special Master recommended that the securities which had been found be turned over to the respective petitioners, and that recommendation was adopted by the Court.

Separate hearings were held with respect to the securities of the Schuerens which have not been found and the Special Master has issued a separate report in which he recommends that the remaining claim of the estate of Arnold Schueren be disallowed and the claim of Eleanore Schueren be allowed in the amount of $17,030.97.

Rule 53(e)(2) of the Federal Rules of Civil Procedure provides, "In an action to be tried without a jury the court shall accept the master's findings of fact unless clearly erroneous." Unless clearly erroneous, the Special Master's findings are binding on the District Court. In re Vernon Hills, Inc., 348 F. 2d 4 (7th Cir.), 1965. Having reviewed the transcript of testimony before the Special Master, and the exhibits introduced by the respective parties, I have

UND CLOSE IN CENTER

concluded that the findings of the Special Master, and his recommended disposition of the respective claims, are correct.

On April 16, 1936, Arnold Schueren granted to the late Leston B. Nay a power of attorney, which authorized and empowered Nay to sell Arnold Schueren's securities, to reinvest the proceeds, and to make any changes as Nay might deem advisable in his sole discretion. At that time, Nay was associated with the brokerage firm of Webber, Darch & Co. In 1942 Nay went from Webber, Darch to Ryan Nichols & Co., to which the account of Arnold Schueren was transferred. Ryan, Nichols subsequently became First Securities Company of Chicago, and Nay became its president and 90 per cent shareholder.

When the Arnold Schueren account was transferred to Ryan, Nichols, Nay sent to Schueren a list of securities which had been received "for safekeeping." Thereafter, the account was handled exclusively by Nay, who supplied Schueren with safekeeping receipts and income statements on First Securities' forms. Dividends and interest were paid by cashier's checks, accompanied by income statements on First Securities letterheads. First Securities, however, never used cashier's checks to make income remittances to its customers, and those made to Arnold Schueren did not come out of the bank account of First Securities.

As the Special Master correctly determined, the primary question with respect to the disposition of the Arnold Schueren claim is whether Schueren intended to rely on Nay as an individual or as an agent of First Securities in his dealings with him. The Master found that Schueren intended to deal with Nay solely as an individual and not as an agent of First Securities, and I must agree. The power of attorney granted to Nay by Schueren named Nay in an individual capacity only, not as an agent. It gave Nay full power and

COPY BOU

authority over Schueren's securities, and that it was not intended to authorize Nay to act as a representative of First Securities is evident from the fact that it was created six years before Nay had any connection with First Securities. The same conclusion was reached in the case of Rosen v. Harde, 238 App. Div. 622, 265 N. Y. Supp. 154 (1933) in which the situation was closely analogous to the facts here. Therefore, the claim of the estate of Arnold Schueren should be disallowed, because Nay, in his defalcations from the Schueren account, was acting not as the agent of First Securities, but as the agent of Mr. Schueren under a power of attorney.

The claimant for the Estate of Arnold Schueren has asserted in its memoranda filed in this court that First Securities should be liable for Nay's acts under the federal securities laws, on the ground that:

> "If the broker-dealer or his employee is vested by a customer with discretionary power to affect transactions with or for the account of the customer, the relationship is one of trust and confidence and the broker-dealer has assumed the role of agent with a fiduciary obligation to the customer." Weiss, Registration and Regulation of Brokers and Dealers, p. 109, 1965.

That principle applies, however, only when the employee is vested with authority as an agent of the broker-dealer. It is, therefore, not pertinent to the situation here, since the authority granted by Schueren to Nay was to act in an individual capacity, and not as an agent for First Securities. See, Ross v. Licht, 263 F. Supp. 395 (S. D. N. Y. 1967); Carr v. Warner, 137 F. Supp. 611 (D. Mass. 1955); Nash v. J. Arthur Warner & Co., 137 F. Supp. 615 (D. Mass. 1955).

It is true, as the Estate argues, that a broker-dealer may be liable for the frauds of its employees if it is guilty of

D CLOSE IN CENTER

failure to supervise. But there is no evidence in this record to establish that First Securities was guilty of inadequate supervision. The fact that an officer maintained private files on the premises is not even remotely analogous to the situations in which securities dealers have been held liable under Rule 10b-5 for inadequate supervision.

Finally, I cannot agree with the view asserted by the Estate that First Securities may be held liable for Nay's fraud under Section 20(a) of the Securities Exchange Act of 1934. 15 U. S. C. Section 78t. That section provides:

> "Every person who, directly or indirectly, controls any person liable under any provision of this chapter or of any rule or regulation thereunder shall also be liable jointly and severally with and to the same extent as such controlled person to any person to whom such controlled person is liable, unless the controlling person acted in good faith and did not directly or indirectly induce the act or acts constituting the violation or causes of action."

Thus, First Securities would be liable for the acts of its "controlled person" under Section 20(a) only if it acted in bad faith or induced the unlawful acts of Nay. There is not sufficient evidence that First Securities acted in bad faith or that it directly or indirectly induced the fraud.

The Special Master found that the situation of Mrs. Eleanore A. Schueren was completely different from that of her late husband, and recommended that her claim in the amount of $17,030.97 be allowed. Mrs. Schueren never executed a power of attorney to Leston B. Nay, and the evidence establishes that she dealt with Nay not as an individual, but as an agent of First Securities. Mrs. Schueren's dealings with Nay were similar to those of Nora A. Moyer whose claim has previously been allowed by the Court. Mrs. Schueren received documents purporting to be safekeeping receipts and monthly statements of her

COPY BOUN

account, all on First Securities forms or letterheads. Thus, the preponderance of the evidence establishes that Nay had apparent authority to deal with Mrs. Schueren as the agent of First Securities, and that Mrs. Schueren intended to deal with him in that capacity. I agree with the Special Master's view that the fact that payments were made by cashier's check is not sufficient to negate Nay's apparent authority, or to raise such suspicion as to cause a person using due diligence to discover that Nay did not have actual authority to act for First Securities in those transactions.

In reviewing the claims of Nora A. Moyer, the court also enunciated the rule in Illinois with respect to the date of valuation of property wrongfully converted. When the date of conversion is not susceptible of ascertainment, the property should be valued as of the date of first notice of the conversion to the owner. The Master found that the date of first notice of the conversion to Mrs. Schueren was June 10, 1968, the date upon which the Securities and Exchange Commission filed its complaint in this action. From expert testimony based on valuation as of that date, the Master found that Mrs. Schueren's outstanding claim should be valued in the amount of $17,030.97.

The receiver has argued that the documentary evidence was insufficient to prove that certain of the claimed securities were actually held by First Securities. The Special Master found otherwise, however, and having reviewed the testimony and exhibits presented to the Master, I am unable to conclude that his findings of fact were clearly erroneous. Therefore, the recommendation of the Special Master that the claim of Mrs. Schueren be allowed in the amount of $17,030.97 will be confirmed.

Mr. Clerk, the receiver's motion to confirm the recommendation of the Special Master (that the claim of Union Bank and Trust Co., as executor of the Estate of Arnold C. Schueren, be denied), will be allowed.

UND CLOSE IN CENTER

The receiver's motion to reject the recommendation of the Special Master (that the claim of Mrs. Eleanore A. Schueren be approved in the amount of $17,030.97), will be denied.

The report of the Special Master in respect of the claims of Eleanore A. Schueren and Union Bank and Trust Company, as Executor of the Estate of Arnold C. Schueren, will be approved in its entirety.

COPY BOUND

OPINION OF THE UNITED STATES

COURT OF APPEALS

FOR THE SEVENTH CIRCUIT

DELIVERED AUGUST 1, 1972.

IN THE UNITED STATES COURT OF APPEALS

• • (Caption—No. 71-1422) • •

Argued April 13, 1972—Decided August 1, 1972

Before HAMLEY, STEVENS and SPRECHER, *Circuit Judges.*

SPRECHER, *Circuit Judge.* This is another sad chapter in the case of Leston B. Nay and the frauds he perpetrated over a long period of years against a great number of innocent investors. The record in this court in the prior appeal of 15 individual escrow participants, Olga Hochfelder et al., has been made part of the record in this appeal. *SEC* v. *First Securities Co.*, ... F. 2d ..... (No. 71-1272, April 12, 1972).

The defendant in the equitable receivership, First Securities Company of Chicago, was registered with the Securities and Exchange Commission as a broker-dealer in securities and was a member of the Midwest Stock Exchange and the National Association of Securities Dealers. On June 4, 1968, Leston B. Nay, president of First Securities and owner of 92 percent of its stock, murdered his wife and committed suicide. He left a suicide note which described First Securities as bankrupt because of his thefts and which characterized the "Schueren account" as being one of "the thefts affecting the Company."

On June 10, 1968, the SEC initiated the receivership action against First Securities. The claim which is the subject matter of this appeal derives from Nay's theft of securities owned by Arnold C. Schueren. The district court appointed a special master to hear and determine the

validity of the various claims against First Securities. In accordance with the recommendation and findings of the special master, the district court disallowed the instant claim on behalf of the estate of Arnold C. Schueren in its entirety, and this appeal followed.

I.

On April 16, 1936, Arnold C. Schueren appointed Nay "to act for me in connection with all matters arising out of or in any way connected with my securities to the same extent and with the same full power and authority as I might personally do if present." On July 7, 1937, "[w]ithout detracting from the general and specific powers contained in that instrument [of April 16, 1936], I further authorize and empower the said Leston B. Nay to sign in my behalf any proxies, transfers, acknowledgments, accounts, receipts or documents for my securities with the same power and authority as I would myself if present."

In July, 1939, Schueren received a letter headed "Webber, Darch & Company, Leston B. Nay, President" and signed Webber, Darch & Company "by Leston B. Nay." The letter stated, "In accordance with your recent request we are pleased to enclose inventory of securities held in safe keeping for your account"; an itemized inventory was enclosed.

Nay joined Ryan-Nichols & Co. as vice-president in 1942. Schueren received a letter dated July 31, 1942, on the letterhead of Ryan-Nichols & Co., signed Ryan-Nichols & Co. "by Leston B. Nay, Vice President." It said, "We have received from Webber, Darch & Co. the following securities, which we placed in safe keeping for your account;" following was an itemized list of securities. The name of Ryan-Nichols & Co. was changed to First Securities Company of Chicago on June 14, 1944, at about

COPY BOUND CLOS

which time Nay became president and principal shareholder.

From 1946 through 1963, First Securities bought and sold securities for Schueren in *bona fide* transactions which appeared in the books and records of First Securities and which were not tainted by any defalcations of Nay. In connection with these transactions, Schueren received confirmations on the printed forms of First Securities.

For all his securities Schueren received safekeeping receipts. Those appearing in the record were on the printed forms of First Securities and acknowledged receipt by "First Securities Company of Chicago" and showing the typed names and written initials of Campbell, Burke and Walker.

Each month Schueren would receive an itemized list of dividends received on the securities purportedly in safekeeping for him, together with a cashier's check for the month's total dividends. Although a few of the dividend itemizations were on otherwise blank paper, the great majority were typed on the printed letterhead of First Securities with the further printed designation "Member, Midwest Stock Exchange."

Under date of March 17, 1959, Schueren received a complete inventory of his purported holdings, typed on the letterhead of First Securities. Schueren found three discrepancies between his own records of his holdings and those on the March 17 inventory list. He pointed them out to Nay, who wrote Schueren a letter dated March 26, 1959, on the printed letterhead of First Securities, acknowledging the three errors and ascribing them to the typist.

Schueren died in 1967; the Union Bank and Trust Company was appointed his executor. The bank then wrote Nay requesting all of Schueren's securities. On April 27, 1967, Nay sent the bank what purported to be a

LOSE IN CENTER

complete inventory of the Schueren holdings, typed on sheets stamped with the name of First Securities. For more than a year, Nay corresponded with the bank and pretended to be in the process of obtaining transfers of the Schueren securities. When on June 4, 1968, he finally told the bank that the security transfers had been completed and were ready for delivery, he committed suicide. Thereafter the bank learned of Nay's thefts of the securities involved in this claim, which were valued at $394,195.39.

II.

Because of the legal conclusions reached in the Hochfelder appeal, it is important to consider the factual basis from which they derived. This court said in *SEC* v. *First Securities Co.*, ... F. 2d ..... (No. 71-1272, April 12, 1972), in the slip opinion at pages 2-5:

> "The fifteen claimants had each been brokerage clients of First Securities, buying and selling securities through First Securities in regular fashion. Each received investment advice from Nay, and each knew Nay to be the president of First Securities. Nay advised each of the claimants that he was able to offer to the claimant an opportunity to invest in a so-called escrow which would yield a high rate of interest. . . . Typically, upon being persuaded by Nay that the escrow was the best possible investment for them, the claimants sold legitimate securities through First Securities for purposes of obtaining the necessary cash to invest in the escrow. First Securities effected the sales, collected its commissions and submitted the proceeds to the claimants, who then drew their personal checks payable to Nay or to a bank for his account. Subsequent transactions with regard to the escrow were not in the form usual to dealings between customers and First Securities, nor was the escrow reflected in periodic accountings by First Securities to the claimants.

COPY BOUND CL

"Upon receipt of the cash investment from the claimants, Nay usually executed a hand-written document which acknowledged such receipt and confirmed the terms of the arrangement. Sometimes Nay gave promissory notes to the claimants. All, or substantially all, of Nay's correspondence with the claimants was written on letterhead stationery of First Securities. Some of the letterhead stationery included the words, 'Leston B. Nay, President,' on the upper left hand portion thereof. All of the stationery bore the legend, 'Member Midwest Stock Exchange,' in addition to the firm's name and address. Although much of Nay's correspondence with regard to the escrow transactions was handwritten by him, a substantial portion was typed by his secretary at First Securities.

"During the early years of Nay's fraudulent enterprise, the claimants were paid interest from time to time based upon their 'investments' in the escrow. Such payments were made by Nay's personal check. . .

"Finally, it is clear that Nay had no actual authority to act for First Securities with regard to the escrow account. It is also clear that First Securities' employees (other than Nay) knew nothing of the nature of the escrow nor, except for his secretary, even of its existence. Nay had forbidden anyone other than himself to open mail addressed to him, and in his absence all such mail was simply allowed to pile up on his desk, even if it was addressed to First Securities for his attention."

On the basis of the above facts, this court concluded that (1) Nay acted with apparent authority as the common law agent of First Securities; (2) First Securities was a "controlling person" as to Nay within the intention of section 20(a) of the Securities Exchange Act of 1934, 15 U. S. C. § 78t(a); (3) First Securities at least aided and abetted Nay in violating section 10(b) of the Securities Exchange Act of 1934, 15 U. S. C. § 78j(b), and Rule 10b-5 promulgated pursuant thereto, 17 C. F. R. § 240.10b-5; and

CLOSE IN CENTER

(4) First Securities failed to satisfy its duty to supervise Nay pursuant to Rule 27 of the Rules of Fair Practice of the National Association of Securities Dealers, Inc. This court held that First Securities was liable for Nay's fraud to the 15 escrow participants on all four theories.

III.

The parties to this appeal, with a commendable willingness to disclose everything which has occurred in the equitable receivership, included in the record here the evidence relating to, and the disposition by the special master (approved by the district court) of two other pertinent claims.

Norman L. Moyer had appointed Nay executor of his will. When Moyer died on March 3, 1958, Nay as executor took custody of his stocks and bonds. In his final account filed in the probate court, Nay recited that the securities had been distributed to the widow, Nora A. Moyer; actually Nay had delivered to her a safekeeping receipt with a First Securities stamp thereon. The securities never appeared in the records of First Securities and were missing at the time Nay took his life. In recommending allowance of the Moyer claim, the special master concluded:

> "The question . . . is whether the transactions purported to have been carried out, on the broker's side, by Mr. Nay individually or by him on behalf of First Securities. And to this question there is a clear answer: The receipt which was signed in the name of First Securities and which contained a First Securities stamp at the top of each page, and the quarterly statements furnished to Mrs. Moyer as an accounting of dividends and interest received, clearly purported to be documents of First Securities. No question is raised as to Mr. Nay's authority to act as agent and validly sign for First Securities. And Mr.

COPY BOUND

Nay, in his death note, listed the Moyer theft as 'affecting the Company'.

"Furthermore, even if the matter is looked at from the point of view of Mrs. Moyer's intentions, there are indications that Mrs. Moyer relied on First Securities so far as the safekeeping of the securities was concerned. . . ."

A second claim recommended for allowance by the special master and allowed by the district court was that of Arnold C. Schueren's wife, Eleanore A. Schueren, whose relation to Nay and First Securities was similar to that of her husband except that she had signed no power of attorney.

In allowing the claim of Mrs. Schueren, the district court concluded:

"Mrs. Schueren's dealings with Nay were similar to those of Nora A. Moyer, whose claim has previously been allowed by the court. Mrs. Schueren received documents purporting to be safekeeping receipts and monthly statements of her account, all on First Securities forms or letterheads. Thus, the preponderance of the evidence establishes that Nay had apparent authority to deal with Mrs. Schueren as the agent of First Securities, and that Mrs. Schueren intended to deal with him in that capacity. I agree with the Special Master's view that the fact that payments were made by cashier's check is not sufficient to negate Nay's apparent authority, or to raise such suspicion as to cause a person using due diligence to discover that Nay did not have actual authority to act for First Securities in those transactions."

IV.

Consideration of the facts leading this court to conclude that the claims of the 15 escrow participants against First Securities should be allowed and of the facts leading the special master and the district court to allow the Moyer

IND CLOSE IN CENTER

and Eleanore Schueren claims, causes us to conclude that the Schueren claim should also be allowed despite the existence of the power of attorney.

The power of attorney was executed by Schueren in 1936 and supplemented in 1937. The power and supplement were typewritten forms in which Schueren's name was inserted in handwriting. There is nothing in the voluminous record before us to indicate that Schueren was ever again reminded of the existence of the power of attorney after 1937.

The only evidence in the record which reflects Schueren's intention and understanding is a memorandum dated May 31, 1957, addressed to the Union Bank & Trust Company, in which he refers to the location of the safekeeping receipts:

> "All our securities, with the exception of a few common stocks are held in Safe keeping by the First Securities Company, 134 South LaSalle Street, Chicago, 3, Ill. Mr. Leston B. Nay is President of this Company."

Like the escrow participants, Schueren was a *bona fide* customer of First Securities quite aside from the tainted Nay transactions. First Securities bought and sold securities for him, he issued his checks payable to First Securities, he received valid confirmations and other documents from First Securities and the books and records of the company reflected these untainted transactions.

What after Nay's death proved to be scores of spurious safekeeping receipts and spurious monthly dividend statements and the spurious inventories in 1959 and 1967 were on the genuine letterheads and forms of First Securities, were apparently in proper order, were often signed by Nay who had "authority to act as agent and validly sign for First Securities," or with the names and initials of persons who were or seemed to be actual officers or em-

COPY BOUND

ployees of First Securities (Campbell, Walker, Burke). Schueren himself kept meticulous books and records. Nothing which occurred during the almost 25 years of Schueren's dealings with First Securities and Nay can be said to have put a reasonable person on notice that anything was amiss. Nay's manipulations of the fraudulent records which were sent to Schueren at least monthly coincided with Schueren's own records of what he believed he owned. Even the trust department of the Union Bank was completely duped by Nay for more than a year after Schueren's death until Nay's suicide.

Nay believed that in his dealings with Schueren he was acting as the agent for First Securities. In his suicide note he said, "The thefts affecting the Company are 1) The Schueren acc't. (Union Bank of Helena . . .) 2) Moyer acc't." He gave detailed instructions to Roy Campbell, the cashier of First Securities, as to where the Schueren files and papers were located.

There is no evidence that anyone at First Securities other than Nay was ever aware of the 1936-37 Schueren power of attorney. There is no evidence that the power was ever used by Nay. Although it may be speculated that it was used, the facts are that Nay was able to dispose of the Moyer and Eleanore Schueren securities without using or even possessing a power of attorney from them.

As we stated in the prior appeal (slip opinion, page 10):

> "Here, First Securities made Nay its president, provided him with the trappings of a successful investment counsellor, held him out as providing such counsel, and then wilfully allowed Nay's enforcement of a rule regarding the opening of mail which was antithetical to the prevention of frauds of the type which occurred."

First Securities also provided Nay with the printed letterheads, printed safekeeping receipts, rubber stamps and

ND CLOSE IN CENTER

other supplies and accoutrements which enabled him to perpetrate and perpetuate his frauds.

For the four reasons upon which this court allowed the escrow claims in the prior appeal, we conclude that this claim should also have been allowed.

The judgment of the district court is reversed.[1]

1. The only case relied upon by the special master and the district court to reach a contrary conclusion, *Rosen* v. *Harde*, 238 App. Div. 622, 265 N. Y. S. 154 (1933), was decided by an intermediate state appellate court prior to the enactment of the Securities Exchange Act of 1934, was not concerned with the unique facts present here and apparently has never been cited since its issuance some 40 years ago.

UNIC
MON
Arr

BRI
T
F

FILE COPY

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1972.

Supreme Court, U. S.
FILED
NOV 8 1972
MICHAEL RODAK, JR., CLERK

No. 72-~~536~~ 563

KEITH B. McKY,

Petitioner,

vs.

UNION BANK AND TRUST COMPANY OF HELENA, MONTANA, as Executor of the Estate of Arnold C. Schueren, Deceased,

Respondent.

BRIEF OF RESPONDENT UNION BANK AND TRUST COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Frank G. Uriell
Ellis A. Ballard
69 W. Washington St.
Chicago, Illinois 60602
Attorneys for
Union Bank and Trust
Company of Helena,
Montana, Executor of
the Estate of Arnold
C. Schueren, deceased,
Respondent

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1972.

No. 72-536

KEITH B. McKY,

Petitioner,

vs.

UNION BANK AND TRUST COMPANY OF HELENA, MONTANA, as Executor of the Estate of Arnold C. Schueren, Deceased.

Respondent.

BRIEF OF RESPONDENT UNION BANK AND TRUST COMPANY IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

Respondent submits that the petition for certiorari should be denied for the following reasons:

(1) Petitioner has already been denied certiorari in Keith B. McKy v. Olga Hochfelder, et al.[1/] - a case closely

---

1/ No. 72-235, cert. den. Oct. 3, 1972 41 U.S. Law Week 3187.

related to this, wherein Petitioner was directed by the Seventh Circuit to allow the so-called "escrow claims" in the pending receivership proceedings. Securities & Exch. Com'n v. First Securities Co. of Chicago, 463 F.2d 981 (7th Cir. 1972). In the instant case the Seventh Circuit expressly relied on its holding and reasoning with respect to the escrow claims in concluding that this Respondent's claims should also be allowed. We respectfully submit that the earlier denial was entirely proper. There was no basis for certiorari in that case and there is likewise none here.

(2) Petitioner argues that the instant case is different because certain powers of attorney are here allegedly involved that were not present in the earlier case. However, Petitioner neglects to point out the complete irrelevance of those powers

of attorney here: they do not figure in any of the transactions on which Respondent relies for establishing its claim. Other than Nay - the defaulting president, no one at First Securities ever relied on the powers of attorney in question or even knew of their existence at any time from the founding of the company until its demise. Nay never claimed to be acting under those powers at any time during his association with First Securities; and the grantor of those powers - Arnold C. Schueren - never thought that Nay was acting under those powers, either. These facts are clearly spelled out in the opinion of the Seventh Circuit, forming the basis of its conclusion that the powers of attorney were irrelevant, here.

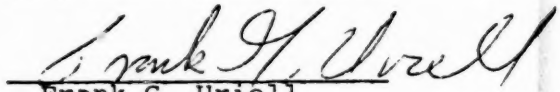
(3) Petitioner's contention that this case should be ruled by Rosen v. Harde, 238 App. Div. 622, 265 N.Y. Supp. 154

(1933) is clearly without merit. That was a 1933 New York Appellate Division case decided before the passage of the Securities Exchange Act of 1934. If ever it was good law, it no longer is. More important, the facts in Rosen v. Harde are fundamentally different from those here. There is every reason to think that - on the facts referred to in the preceding paragraph - the Rosen v. Harde court would have decided this case the same way the Seventh Circuit did.

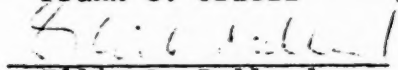
(4) Finally, Petitioner's efforts to distinguish Blackburn v. Witter, 201, Cal. App. 2d 518, 19 Cal. Rptr. 842 (1962) are not successful. Contrary to the Petitioner's contentions, that case does not turn on any peculiarities of California law. It turns instead - as this one does - on Sections 261 and 262 of the RESTATEMENT (SECOND) AGENCY (1958) which sections state well-recognized common law agency principles that are nowhere

in doubt. The contention that the Seventh Circuit misapplied Illinois law is, we believe, a wholly groundless contention.

Respectfully submitted,



Frank G. Uriell



Ellis A. Ballard
69 W. Washington St.
Chicago, Illinois 60602
Attorneys for
Union Bank and Trust
Company of Helena,
Montana, Executor of
the Estate of Arnold
C. Schueren, deceased,
Respondent

Certificate of Service

I hereby certify that the attached brief has been served by mail on all parties entitled to service by depositing three copies in a United States mailbox, with first class postage prepaid, addressed to counsel of record at their post office address.

Frank G. Uriell